

New Developments in Corporate Takeovers and Defense Measures in Japan

By Kanda Hideki

■ New Era of Hostile Takeovers

Since the beginning of 2005, a dizzying spectacle of hostile corporate takeover bids and defense measures has been unfolding. A fight for management control over Nippon Broadcasting System between livedoor and Fujisankei Communications Group has captivated media attention and stoked interest among the public. Although a hostile takeover bid implies a bid for equity without the consent of the target's management, livedoor, in its hostile bid for Nippon Broadcasting System, a listed company on the Tokyo Stock Exchange (TSE), did not choose the commonly used method of a stock tender offer, but acquired the shares during off-hours trading. To defend itself, Nippon Broadcasting System attempted to dilute livedoor's shareholding ratio by issuing share-purchase warrants to Fuji Television Network, but the court order

halted the warrants issue and the defense measure failed. Several more twists and turns brought a settlement between the companies, with livedoor's takeover bid ending in failure.

The event was a wake-up call for the Japanese corporate world – to the possibility of hostile takeovers. A frantic search for defense measures ensued among listed companies. Several companies submitted various proposals to general shareholders' meetings in late June. In some of these companies, proposals were opposed and voted down by institutional investors holding major equity stakes.

■ The Takeover Defense Debate

Since September 2004, the Corporate Value Study Group of the Ministry of Economy, Trade and Industry (METI) has been examining concepts associated with takeover defenses from legal codifi-

cation and market receptiveness. The case of Nippon Broadcasting System, in which the hostile bidder and its target invoked the issue of corporate value, elicited sudden interest from the public. The Study Group therefore came out with a framework establishing the points at issue in March 2005, and published the main body for which it widely solicited opinions from the public in April. At almost the same time, an amendment to regulate off-hours trading – the method used by livedoor to acquire shares of its takeover target – was hurriedly included in a bill to revise the Securities and Exchange Law, which was passed in June, with the section regulating off-hours trading implemented at unprecedented speed in July.

In April, the TSE asked listed companies to exercise self-restraint for excessive defense measures and related large-scale stock splits, from the perspective of protecting investors. The Study Group

Figure 1 Worldwide M&A Market Trend

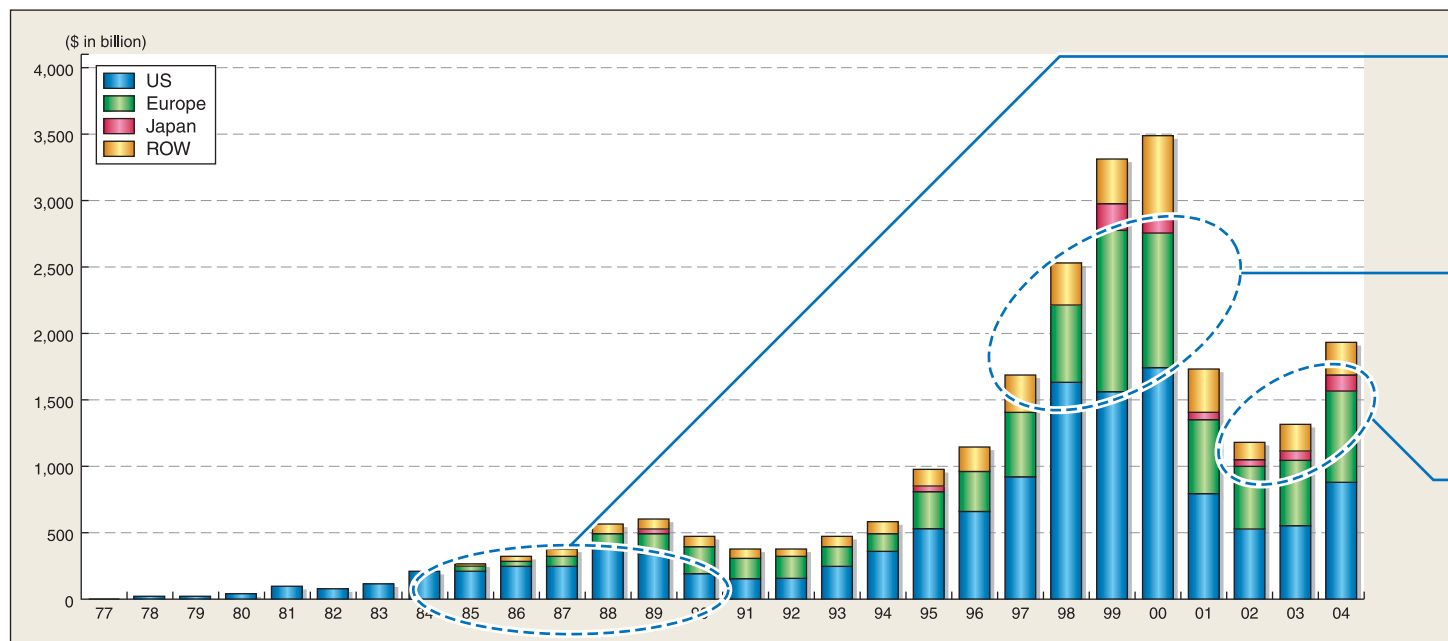


Photo: Kyodo News



(From left) Kamebuchi Akinobu, President and CEO of Nippon Broadcasting System, Horie Takafumi, President and CEO of livedoor, Hieda Hisashi, Chairman and CEO of Fuji TV and Murakami Koichi, President and COO of Fuji TV (All titles as of April, 2005)

released its final report in May, and at the same time METI, together with the Ministry of Justice, promulgated the Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders' Common Interests. Although the Guidelines lack the force of law, they have significant practical effects.

The Guidelines establish the following three principles and offer specific examples. The first is the principle of protecting and enhancing corporate value and the shareholders' common interests. The purpose of defense measures is to preserve and to improve corporate value – signified by corporate assets, earning power, stability and growth potential, which all contribute to shareholder interests, and by extension the common interests of shareholders, i.e., interests shared by all shareholders. The second principle is prior disclosure and respect for shareholder's will. When defense measures are adopted, their contents and details should be disclosed and they should reflect the will of shareholders.

The defense measures are to be adopted based on the approval of the general meeting of shareholders, or if adopted by the board of directors, the defense measures should be subject to rejection by a general shareholders' meeting. The third is the principle of necessity and reasonableness. This principle postulates that defense measures must not be excessive, and they should protect shareholders' assets and prevent abuse by management.

Subsequently, in June, the court agreed to halt the issue of share-purchase warrants by one company, under a scheme implemented at "peace time," i.e., not subject to a hostile takeover bid. In May and June, some listed companies adopted

the so-called advance-warning defense measure, as well as submitting a scheme for share-purchase warrants combined with a trust arrangement at their general shareholders' meetings. Moreover, in July, the government announced it would consider a review of the regulations governing stock tender offers.

US (since the 80s)

- Hostile takeovers increased during the M&A boom in the 80s. Surprise attacks and excessive defenses took place.
- Excessive defense measures were usually attacked by institutional investors and invalidated by court decisions.
- The rights plan survived as reasonable effective measures.

–The M&A framework in the US today provides a fair balance among conflicting interests in takeover situations, with the shareholders generally retaining final control.

EU (since the 90s)

- “The Takeover Directive,” including the mandatory offer rule, was adopted in 2004. Each country has an option to opt out of rules on defense measures.

–The EU has established rules on hostile takeovers during the last 10 years.

–There are two types of defense measures in the EU; The UK type (frustrating an action prohibited in principle), The Continental Europe type (golden shares and super-voting stock).

Japan (since 2000)

- Friendly M&As have increased since the late 90s.
- The threat of hostile takeovers has also increased due to the dissolution of cross-shareholdings and the changing image of acquisitions.

–Despite the M&A boom, Japan lacks fair rules on hostile takeovers.

–A lack of rules allows coercive takeovers and excessive defenses.

Source : Hattori Nobumichi, assistant professor, Graduate School of International Corporate Strategy, Hitotsubashi University

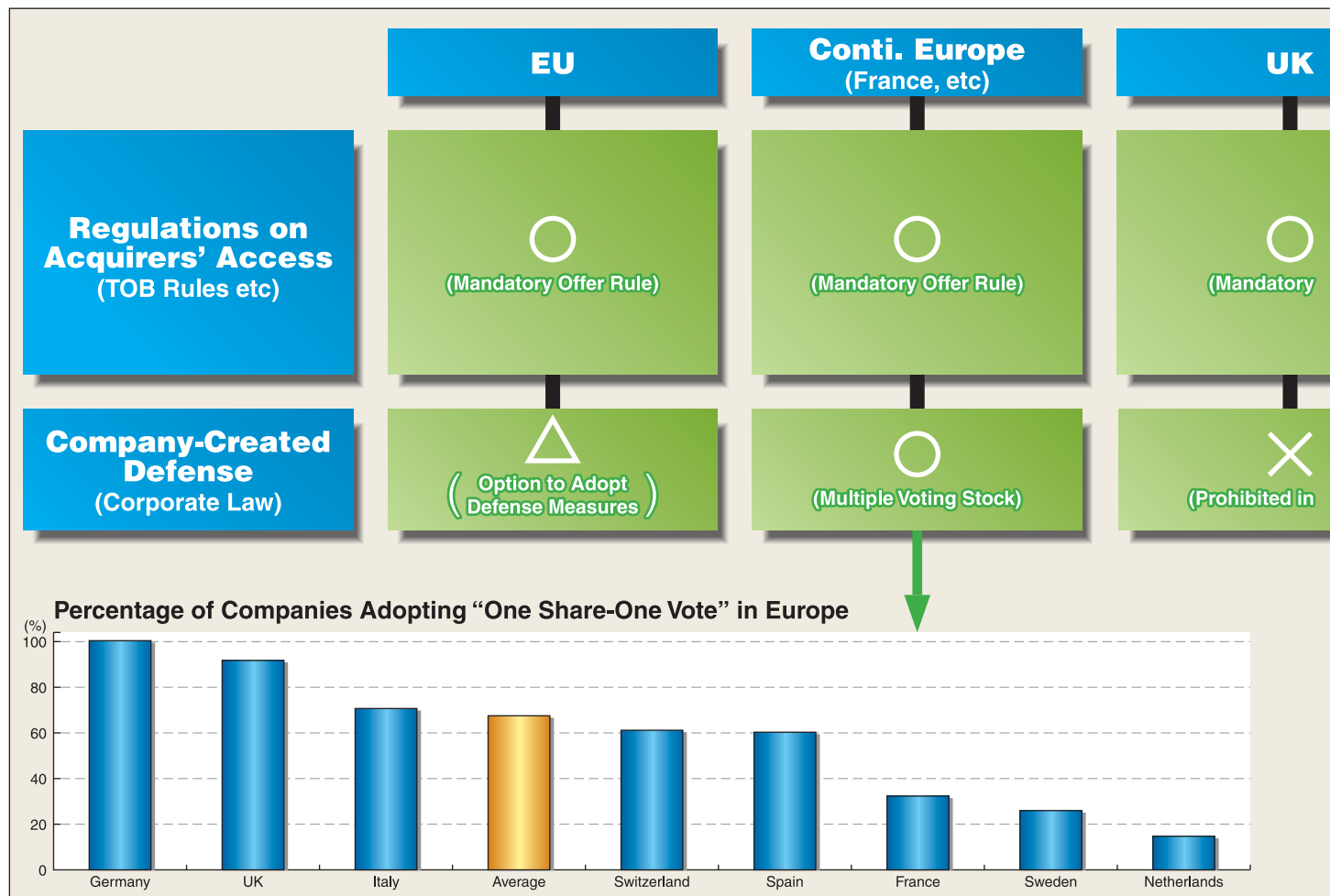
The New Corporate Act

Meanwhile, in the area of legislation, the Corporate Act section of the existing Commercial Code, which was enacted in 1999 using old-style *katakana* and *kanji* format, was separated out and its content was significantly revised with the usual *hiragana* and *kanji* format (to make it easier to read). It was submitted to the Diet as a bill for a new corporate law in March 2005. After some revisions by the House of Representatives, the bill was passed into law, with enforcement slated for 2006. The new Corporate Act will facilitate the

adoption of various types of defense measures. First, concerning ways of diluting a hostile bidder's percentage of voting rights (the so-called rights plan): (1) classified stock may be issued under the current law, so that a hostile bidder's excessively bought shares can be compulsorily converted to shares with restricted voting rights or to cash, but under the new law, procedures will be available to convert outstanding shares of common stock into classified stock devised under this type of takeover defense; (2) under the new Corporate Act, companies can cancel a hostile bidder's share-purchase warrants in case the

bidder has excessively bought up shares while other shareholders can receive share-purchase warrants automatically. Second, regarding the method of issuing shares with veto rights (the so-called golden shares) to friendly corporations, even though this is already possible under the current law, there is a problem that these shares may secretly be sold and end up in the wrong hands, creating a need to restrict transfer. Under the current law, however, only a limited range of share classes are available. Companies are able to impose transfer restrictions on subsets of share classes under the new Corporate Act.

Figure 2 Comparison of M&As Regulations



Source : Ministry of Economy, Trade and Industry

Are Takeover Defense Measures Good or Bad?

Viewed from the perspective of society and the national economy, hostile takeovers are not always negative. If there are positive takeovers, there will also be negative ones. The questions at issue concern the criteria for the distinction between positive and negative, and who should be the judge. The above-mentioned Corporate Value Study Group has attempted to sort out the logic surrounding these issues. The conclusion is that the yardstick for a distinction between desirable “good” and

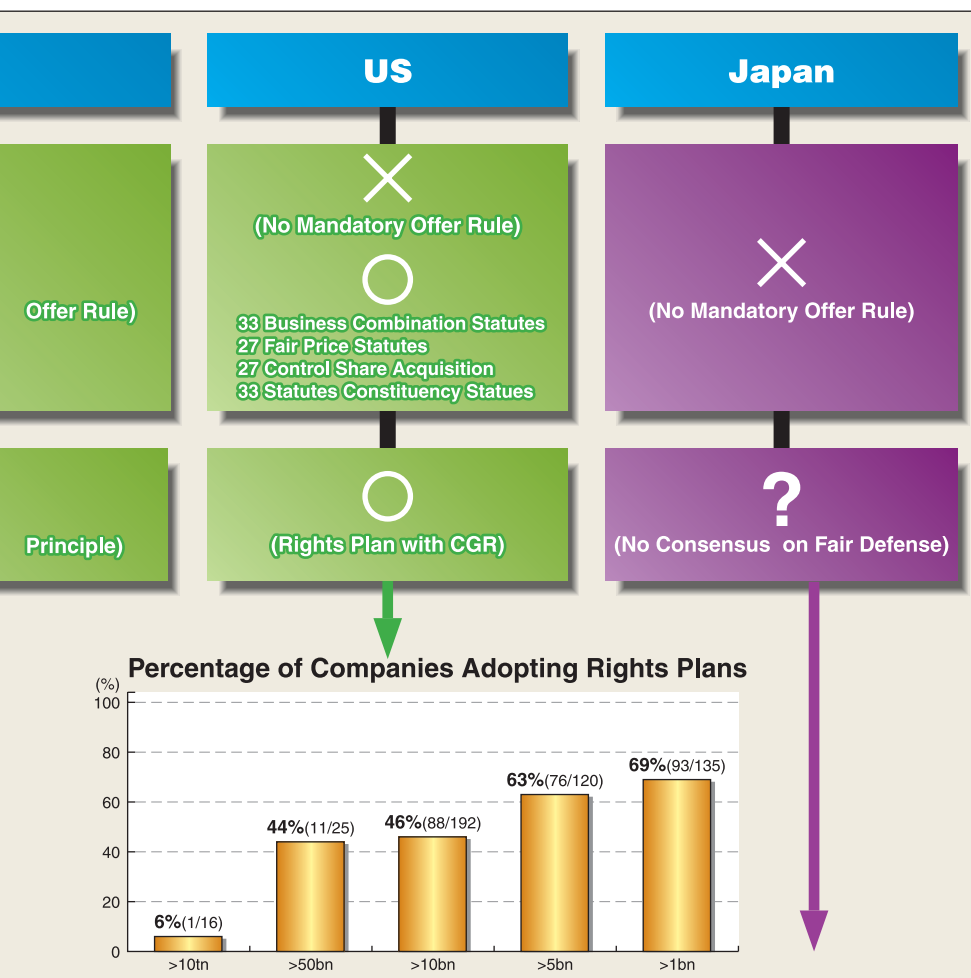
undesirable “bad” takeovers is corporate value. In other words, a takeover is good if it increases corporate value, and if corporate value is lost, it is bad. Applied to hostile takeovers, those that are connected with the depreciation of corporate value should not be allowed to go ahead, rendering a defense reasonable. Conversely, a defense is unreasonable if it seeks to thwart a takeover bid that will increase corporate value.

Obviously, the real difficulty lies in determining who should be the judge. Concerning the adoption of defense measures before a bid, opinions may favor a resolution by the general share-

holders’ meeting, or by the board if certain conditions are met. Even assuming that defense measures are adopted at “peace time” when a specific hostile bidder does emerge and the target company is thrown into “war time,” someone will still have to decide whether or not to activate those defenses, depending on whether the takeover would increase or decrease corporate value. Since there will not be enough time to convene a general shareholders’ meeting, opinions are divided on what should be done: let the board decide, have a neutral third party decide, or make no decision at all and leave the matter to the drift of investors’ stock market trading.

Fortunately, the United States and European countries have already accumulated experience in this area, from which Japan can draw various insights. Irrespective of countries’ legal systems, listed stock companies in essence follow the same design worldwide. The same can be said about the question of who “owns” a company, which abruptly becomes an issue when a takeover defense occurs. Regarding regulations governing stock companies, Japan must protect its tradition, but at the same time, globalization should be adopted.

As mentioned above, enforcement of the new Corporate Act will increase the range of possible takeover defenses. However, while such defenses may be “possible” for the purposes of the law, courts may still impose injunctions, and stock exchanges may not accept these defenses for the listed companies. This is where the above-mentioned Guidelines and the requirements raised by the stock exchange may have their roles to fulfill. Japan still hugely lacks experience, and this is an area where wisdom and ingenuity will be required. To join the league of capitalist industrialized countries, Japan’s episode of trial and error in the field of takeover defense may well have to continue for some time to come. **JS**



Kanda Hideki is a professor of the University of Tokyo Graduate Schools for Law and Politics.